In the Supreme Court of the United States

OCTOBER TERM, 1950

No. 634

PHILIP S. PARKER, JR., PETITIONER

v.

DENIS W. DELANEY, Collector of Internal Revenue for the District of Massachusetts

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ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Court of Appeals (R. 21-28) is reported at 186 F. 2d 455. The findings of fact and opinion of the District Court (R. 11-17) are unreported.

JURISDICTION

The judgment of the Court of Appeals was entered on December 29, 1950. (R. 28.) The petition for a writ of certiorari was filed on March 26, 1951. The jurisdiction of this Court is invoked under 28 U.S.C., Section 1254.

QUESTION PRESENTED

Whether upon conveyance of the properties concerned to the mortgagees, the taxpayer realized a taxable gain with respect to those properties, under the provisions of Section 111 of the Internal Revenue Code.

STATUTE AND REGULATIONS INVOLVED

These are set out in the Appendix, *infra*, pp. 9-12.

STATEMENT

The taxpayer is engaged in managing real estate properties consisting mainly of apartment houses. From 1932 through 1936 a partnership of which the taxpayer was a member, and to all the business of which he has succeeded, negotiated arrangements with savings banks to take over certain properties which the banks had foreclosed. (R. 11-12.)

In the course of this business the partnership concluded arrangements with the Haverhill Savings Bank and the Merrimack River Savings Bank to take over and operate the four properties involved in this case. The banks, between February 1933 and December 1936 (R. 14), deeded these properties to an individual who acted as a straw for the partnership and the straw gave the banks a note and mortgage on each property running for three years. The straw also gave powers of attorney to the partnership to operate the properties, a recorded second mortgage on each property and an unrecorded deed to each of the properties. None

of these instruments was executed by the partnership or the taxpayer, and no agreement was made which restricted the right of the banks to foreclose these mortgages in event of default, or which obligated the partnership or the taxpayers to continue the management of the properties. (R. 12.)

In 1945 the mortgages were in default and an agreement was reached between the taxpayer and the banks whereby the latter took back the properties and the taxpayer caused the straws to give quitclaim deed to the banks, the first mortgagees. The second mortgages were discharged of record. (R. 12-13.)

In his income tax return for 1945 the taxpayer treated the face amounts of the mortgages at the time the properties were conveyed to the mortgagees as sales prices of the properties, and the difference between those amounts and the amounts of the mortgages when the properties were acquired, less depreciation, were treated as capital gains, resulting in a total long term capital gain with respect to these properties of $31,291.10. (R. 13.)

During the time he held these properties the taxpayer (and initially the partnership), for tax purposes, reported all the income and took all deductions to which he would be entitled as owner, including deductions for depreciation. (R. 13.)

After payment of his 1945 income tax, the tax-

payer filed a claim for refund, in the sum of $4,533.31 (R. 11), of tax and interest resulting from the inclusion in his income of a long term capital gain of $15,645.55 (R. 4) from the disposition of these properties. After failure of the Commissioner of Internal Revenue to act thereon, the taxpayer instituted suit in the District Court for recovery of the tax and interest. (R. 13.) The District Court held in favor of the Collector (R. 17), and the Court of Appeals affirmed (R. 28).

ARGUMENT

1. The court below correctly held that this case is controlled by *Crane* v. *Commissioner,* 331 U. S. 1. There the taxpayer acquired by bequest an apartment house subject to an unassumed mortgage equal to the value of the property. She operated the property for several years, claiming and being allowed deductions for taxes and operating expenses of the property, interest on the mortgage, and depreciation deductions on the building. When foreclosure was threatened, she sold the property for $3,000 to a third party subject to the mortgage. She contended that her gain on the sale should be restricted to the amount of cash received. The Court held that the thing she acquired was the physical property itself, or the owner's right to possession and use, not merely her equity; that basis for gain or loss included the amount of the mortgage (which was equal to the value of the property)

on which she had taken depreciation deductions; and that the amount of the mortgage at the time the property was sold was to be included in the benefit received therefor.

The taxpayer (Pet. 5-6) attempts to distinguish the *Crane* case on two grounds, first, that the properties here were conveyed to the mortgagees rather than sold to a third party, and second, that he received no "boot." However, it is clear that this conveyance to the mortgagees provided the requisite closing with respect to the property; this would be true regardless whether the transaction took the form of a conveyance to a third party as in the *Crane* case, *supra,* a foreclosure sale (*R. O'Dell & Sons Co.* v. *Commissioner,* 8 T. C. 1165, affirmed 169 F. 2d 247 (C. A. 3d); *Mendham Corp.* v. *Commissioner,* 9 T. C. 320), abandonment (Cf. *Jamison v. Commissioner,* 8 T. C. 173), or, as here, a deed to the mortgagees in lieu of foreclosure (*Lutz & Schramm Co.* v. *Commissioner,* 1 T. C. 682).

The second ground for distinction suggested by the taxpayer is similarly without basis. On the taxpayer's theory, if he had received only one dollar "boot," that would have rendered the property subject to tax on the gain of more than $30,000, whereas the lack of that one dollar boot would permit this amount of gain to go untaxed. Of course, such a tax result could be reached only in utter disregard of the economic realities of the situation.

As pointed out by Judge Fahy for the Court of Appeals (R. 25):[1]

> The added factor there, not present here, that boot was paid over and above the mortgages, is not material so long as the value of the properties was not less than the liens. Boot served to show this in the *Crane* case, but the payment of boot is of course not the only means of showing whether or not value is equal to or more than the liens on the property disposed of.

The *Crane* decision permits a taxpayer to secure depreciation under Section 23(l) of the Internal Revenue Code, Appendix, *infra*, p. 9, computed on a basis in excess of the taxpayer's actual out-of-pocket investment (as here). It accomplishes this result by assuming in effect that he will later have to invest an additional amount equal to the indebtedness in order to retain the property, and hence at the start he is given credit in his basis for depreciation for such assumed later investment. This approach permits depreciation at a rate consistent with the market value of the property when acquired and affords competitive equality with

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[1] It should be noted that the court below expressly approved (R. 26) the District Court's conclusion (R. 15) that the value of the property equaled the mortgages. In the situation of mortgaging over cost, the Tax Court recently rejected the theory of the taxpayer that the gain is taxable at the time of placing the mortgage and held that it was taxable gain at the time the mortgagee foreclosed. *Woodsam Associates, Inc.* v. *Commissioner*, 16 T. C. No. 80. For a full discussion of the relevant considerations, see Note, 6 Tax L. Rev. 319 (1951).

other taxpayers owning unencumbered property. But if a tax windfall is to be prevented, the basis credit for the assumed investment must, on disposition of the property, whether by sale, foreclosure, abandonment or otherwise, be balanced by a realization of the same amount. That is precisely the result reached by this Court in the *Crane* case and by both courts below in this case.

2. There is no merit in taxpayer's contentions (Pet. 4-5) regarding Chief Judge Magruder's concurring opinion. Observations in that opinion (R. 27) concerning a possible alternative basis of computation of gain were, in view of his concurrence in the decision, obviously not intended to express disagreement with the result. However "novel" and "unsupported by any authority" they may appear to petitioner, Chief Judge Magruder's views provide no basis for review here. Nor is there merit in taxpayer's contention (Pet. 6) that the transaction here constituted a gift. As found by the District Court (R. 16):

> It would appear from the foregoing that the plaintiff passed the deeds to the mortgagees to forestall a threatened foreclosure, at least as to the properties with which the Merrimack River Savings Bank was concerned.

CONCLUSION

The decision below is correct, and there is no conflict of decisions. The petition for certiorari should be denied.

Respectfully submitted,

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APRIL, 1951.

APPENDIX

Internal Revenue Code:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * *

(l) [As amended by Section 121(c), Revenue Act of 1942, c. 619, 56 Stat. 798] *Depreciation Deduction.*—A reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence)—

(1) of property used in the trade or business, or

(2) of property held for the production of income.

* * * * *

(n) *Basis for Depreciation and Depletion.*—The basis upon which depletion, exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be as provided in section 114.

* * * * *

(26 U.S.C. 1946 ed., Sec. 23.)

SEC. 111. DETERMINATION OF AMOUNT OF, AND RECOGNITION OF, GAIN OR LOSS.

(a) *Computation of Gain or Loss.*—The gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in section 113(b) for determining gain, and the

loss shall be the excess of the adjusted basis provided in such section for determining loss over the amount realized.

(b) *Amount Realized.*—The amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received.

* * * * *

(26 U.S.C. 1946 ed., Sec. 111.)

SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

(a) *Basis (unadjusted) of property.*—The basis of property shall be the cost of such property; except that * * *

* * * * *

(b) [As amended by Sec. 130(b), Revenue Act of 1942, c. 619, 56 Stat. 798] *Adjusted Basis.*—The adjusted basis for determining the gain or loss from the sale or other disposition of property, whenever acquired, shall be the basis determined under subsection (a), adjusted as hereinafter provided.

(1) *General Rule.*—Proper adjustment in respect of the property shall in all cases be made—

(A) For expenditures, receipts, losses, or other items, properly chargeable to capital account, but no such adjustment shall be made for taxes or other carrying charges for which deductions have been taken by the

taxpayer in determining net income for the taxable year or prior taxable years:

(B) in respect of any period since February 28, 1913, for exhaustion, wear and tear, obsolescence, amortization, and depletion, to the extent allowed (but not less than the amount allowable) under this chapter or prior income tax laws. * * *

* * * * *

(26 U.S.C. 1946 ed., Sec. 113.)

Treasury Regulations 111, promulgated under the Internal Revenue Code:

SEC. 29.23(l)-4. *Capital Sum Recoverable through Depreciation Allowances.*—The capital sum to be replaced by depreciation allowances is the cost or other basis of the property in respect of which the allowance is made. (See sections 113(a) and 114.) * * *

SEC. 29.23(l)-5. *Method of Computing Depreciation Allowance.*—The capital sum to be recovered shall be charged off over the useful life of the property, either in equal annual installments or in accordance with any other recognized trade practice, such as an apportionment of the capital sum over units of production. * * * If the cost or other basis of the property has been recovered through depreciation or other allowances no further deduction for depreciation shall be allowed. The deduction for depreciation in respect of any depreciable property for any taxable year shall be limited to such ratable amount as may reasonably be considered necessary to recover during

the remaining useful life of the property the unrecovered cost or other basis. * * *

SEC. 29.113(b)(1)-1. *Adjusted Basis: General Rule.*—The adjusted basis for determining the gain or loss from the sale or other disposition of property is the cost of such property * * *.

The cost or other basis shall be properly adjusted for any expenditure, receipt, loss, or other item, properly chargeable to capital account, including the cost of improvements and betterments made to the property. * * *

* * * * *

The cost or other basis must also be decreased by the amount of the deductions for exhaustion, wear and tear, obsolescence, amortization, and depletion to the extent such deductions have in respect to any period since February 28, 1913, been allowed (but such decrease shall not be less than the amount of deductions allowable) under chapter 1 or prior income tax laws. * * *

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